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FILED
MAR 4 - 2008
OFFICE OF THE CLERK
SUPREME COURT, U.S.

No. 07-801

IN THE

Supreme Court of the United States

BILLY D. DOBBS JR.,

Petitioner,

v.

RICHARD MEHRLICH,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF

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INTRODUCTION

The Respondent argues that there exists no "compelling reason" to grant the Petition. Specifically, the Respondent asserts that the Bankruptcy Court properly applied collateral estoppel to the arbitration proceeding, the lower court's decisions do not conflict with this Court's decision in *Brown v. Felsen*, 442 U.S. 127 (1979), there is no conflict between the Circuits, and that the Second Circuit's Summary Order is not in conflict with a prior Second Circuit decision.

The Respondent, in interpreting the caselaw cited in the Petition, fails to apprehend that collateral estoppel can only be applied under Section 523(a)(2)(A) of the Bankruptcy Code ("Section 523(a)(2)(A)") when the prior proceeding's finding of fraud applied the exact standard for fraud under Section 523(a)(2)(A). Therefore, if the standard employed in the prior proceeding's finding of fraud contained any variance than the standard required under Section 523(a)(2)(A), collateral estoppel cannot be used to find non-dischargeability. Thus, in this case, the Arbitrator's variance from the Section 523(a)(2)(A) standard of fraud, by employing a different standard which also considers the Petitioner's position as a fiduciary to Respondent, cannot be used for Section 523(a)(2)(A) utilizing the doctrine of collateral estoppel.

REASONS FOR GRANTING THE PETITION

I. CONTRARY TO RESPONDENT'S ASSERTION, *BROWN* DOES REQUIRE THAT A FACTUAL FINDING OF FRAUD BE BASED ON THE EXACT ELEMENTS OF FRAUD UNDER SECTION 523(a)(2)(A) IN ORDER FOR THE PRIOR FINDING TO BE GIVEN COLLATERAL ESTOPPEL EFFECT FOR NON-DISCHARGE-ABILITY.

As set forth in the Petition, the Arbitrator based his finding of fraud, not on the classic elements of fraud, which are essentially the same as those under Section 523(a)(2)(A), but also due to the Petitioner's position as a fiduciary. Thus, the Bankruptcy Court, under *Brown*, could not have used the Arbitrator's finding of fraud, via collateral estoppel, as a basis for non-dischargeability, since being a fiduciary is not an element under Section 523(a)(2)(A). As this Court set forth in *Brown*, the factual findings must be made using a standard *identical* to those under 523(a)(2)(A). Since, under Section 523(a)(2)(A), whether the Petitioner was a fiduciary is not a factor, the Bankruptcy Court should not have given the Arbitrator's finding of fraud collateral estoppel effect.

The Respondent argues, on page 11 of his Brief in Opposition (the "Opposition"), that the legal standard *Brown* was speaking of was the burden of proof, and not the elements of fraud under 23(a)(2)(A). That is clearly inaccurate. In point of fact, the Court in *Brown* never discussed the burden of proof, but was indeed concerned only with the elements of a determination of fraud in a

cause of action brought in state court. The Court in *Brown* stated that the legal standard used in the state proceeding must be the same as the legal standard the Bankruptcy Court would have used. As set forth in the Petition, the elements of fraud under Section 523(a)(2)(A) are essentially the same as that of common law fraud, which does *not* include consideration of whether the Petitioner was a fiduciary. Thus, in this case, where the Arbitrator factored in the Petitioner's position and special duties and responsibilities as a fiduciary in order to make a finding of fraud, essentially acknowledging that but for Petitioners special status as a fiduciary no finding of fraud could have been made, such a finding of fraud cannot be given collateral estoppel effect.

II. CONTRARY TO THE RESPONDENT'S ARGUMENT, THE SECOND CIRCUIT'S SUMMARY ORDER CONFLICTS WITH THE EIGHTH AND FIFTH CIRCUITS SINCE THE ARBITRATOR USED A STANDARD FOR FRAUD WHICH VARIED FROM THE EXACT STANDARD UNDER SECTION 523(a)(2)(A).

The Respondent argues, on page 13 of his Opposition, that the Eighth Circuit's decision in *Owens v. Miller*, 276 F.3d 424 (8th Cir. 2002), does not conflict with the Second Circuit's Summary Order since *Owens* deals with "completely different issues" than those raised in this case. However, Respondent ignores the fact that the distinction of whether a finding of fraud was combined with a finding of liability under the Securities Act, as in *Owens*, or whether combined with a fiduciary responsibility, raises the same fundamental question of whether a Bankruptcy Court can combine

two separate and fundamentally independent provisions of law to find dischargeability under Section 523(a)(2)(A). In *Owens*, the Eighth Circuit held that it could not. *Id.*, at 429 ("We see nothing in the Bankruptcy Code or the securities laws indicating that these two provisions of law should be combined in the manner the bankruptcy court did.") Thus, the Second Circuit Summary Order, which affirmed the Bankruptcy Court's finding of non-dischargeability based on the combinations of the doctrines of common law fraud and fiduciary duty, conflicts with the Eighth Circuit.

Similarly, the Second Circuit's holding is in conflict with the Fifth Circuit's decision in *Miller v. J.D. Abrams, Inc., (Matter of Miller)*, 156 F.3d 598, 602 (5th Cir., 1998), *cert. denied*, 526 U.S. 1016, 119 S. Ct. 1249, 143 L. Ed. 2d 347 (1999). In *Miller*, the Fifth Circuit did not utilize collateral estoppel even though the jury found that the appellant misappropriated trade secrets, since the jury's finding did not include a finding of fraudulent intent, an element necessary under Section 523(a)(2)(A). Thus, even though the Bankruptcy Court may have extrapolated from the jury's findings that there was an such intent, the Fifth Circuit held that, unless such explicit finding was made at the state court proceeding, the Bankruptcy Court cannot extrapolate anything from the findings of the prior proceeding except that which was explicitly found. Thus, since the jury's findings lacked the element of fraudulent intent, it cannot be used to find non-dischargeability vis-a-vis collateral estoppel. Indeed, any variance from the elements of Section 523(a)(2)(A) would preclude the prior proceeding's findings being used as a basis for non-dischargebaility.

The Respondent argues, on page 14 of his Opposition, that *Miller* should be narrowly interpreted, and "is merely an illustration of classic principles of collateral estoppel." However, the Petitioner's interpretation, that *Miller* stands for the principle that, for purposes of non-dischargeability, the prior proceeding's findings must explicitly use *only* the elements found under Section 523(a)(2)(A) is borne out in *Federal Insurance Company v. Gilson*, 250 B.R. 226 (Bnkr. E.D. VA. 2000), which interprets *Miller* as necessitating an identity of standards to apply collateral estoppel as follows:

> The Supreme Court pointed out that the elements of a state law fraud or other action may not be the same as the elements of nondischargeability. For example, under § 523(a)(4), fraud by a fiduciary is not dischargeable. But, the nature of a fiduciary under § 523(a)(4) may be different, and narrower, than under state law. *Davis v Aetna Acceptance Co.*, 293 U.S. 328, 333, 55 S. Ct. 151, 153, 79 L. Ed. 393 (1934); *Miller v. J.D. Abrams, Inc., (Matter of Miller)*, 156 F.3d 598, 602 (5th Cir., 1998), *cert. denied*, 526 U.S. 1016, 119 S. Ct. 1249, 143 L. Ed. 2d 347 (1999); 4 COLLIER ON BANKRUPTCY P 523.10[1][C], at 523-73 (15th ed. rev., 1998).
>
> For these reasons — the waste of resources by creditors, debtors and courts in forcing the litigation of all potential dischargeability issues in every pre-petition collection case for fear that the debtor might file bankruptcy in

> the indeterminate future; the expertise of the bankruptcy courts in resolving dischargeability issues; and curbing creditor abuse — the Supreme Court declined to give res judicata effect to state court judgments obtained prior to the filing of a petition in bankruptcy. n8

Federal Insurance Company, at 238.

Thus, the Second Circuit Summary Order, giving preclusive effect to the Arbitrator's Decision even though the fraud standard used by the Arbitrator is not identical to the fraud needed for Section 523(a)(2)(A), conflicts with the Fifth Circuit's holding in *Miller* that requires that the elements of fraud used in the prior proceeding cannot vary in any way from the elements under Section 523(a)(2)(A) in order to invoke collateral estoppel to find non-dischargeability. Accordingly, the Arbitrator's variance from the Section 523(a)(2)(A) standard, by utilizing the Petitioner's position as a fiduciary, bars the Arbitrator's Decision from being used as the basis for non-dischargeability vis-a-vis the doctrine of collateral estoppel.

III. CONTRARY TO THE RESPONDENT'S CONTENTION, THE SECOND CIRCUIT'S SUMMARY ORDER IS IN CONFLICT WITH ITS PRIOR HOLDING IN *BALL*

As stated in the Petition, the Second Circuit's prior decision in *Ball v. A.O. Smith Corp.*, 451 F.3d 66 (2d Cir. 2006), supports the Petitioner's argument that an identity of standards is required for "factual" collateral

estoppel under Section 523 of the Bankruptcy Code, and, thus, the decision in this case conflicts with the Second Circuit's own precedent.

The Respondent argues, on page 15 of his Opposition, that *Ball* merely stands for the notion that, in order for preclusion to apply, there has to be an identity of issues. However, in point of fact, the Second Circuit in *Ball* affirmed the lower court's application of collateral estoppel concerning non-dischargeability under Section 523(a)(6) of the Bankruptcy Code only because the Fifth Circuit had previously adopted standards under § 1927 which require findings that are the equivalent of malice. *See, Id.*, at 70. Thus, the definition of what is required under § 1927, and that which is required under Section 523(a)(6), are one and the same.

In this case, however, nowhere in the definition of fraud under Section 523(a)(2)(A) do we find a hint, even to suggest combining the elements of fraud with a fiduciary duty. Thus, the standard the Arbitrator employed in finding fraud, which factored in the Petitioner's position as a fiduciary does not fit into the definition of fraud under Section 523(a)(2)(A), and therefore could not be used as a basis for non-dischargeability through collateral estoppel.

Accordingly, the Court's intervention is necessary to resolve the conflict between the Second Circuit and Eighth and Fifth Circuits, and, indeed, to secure and maintain uniformity in the Second Circuit as well.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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